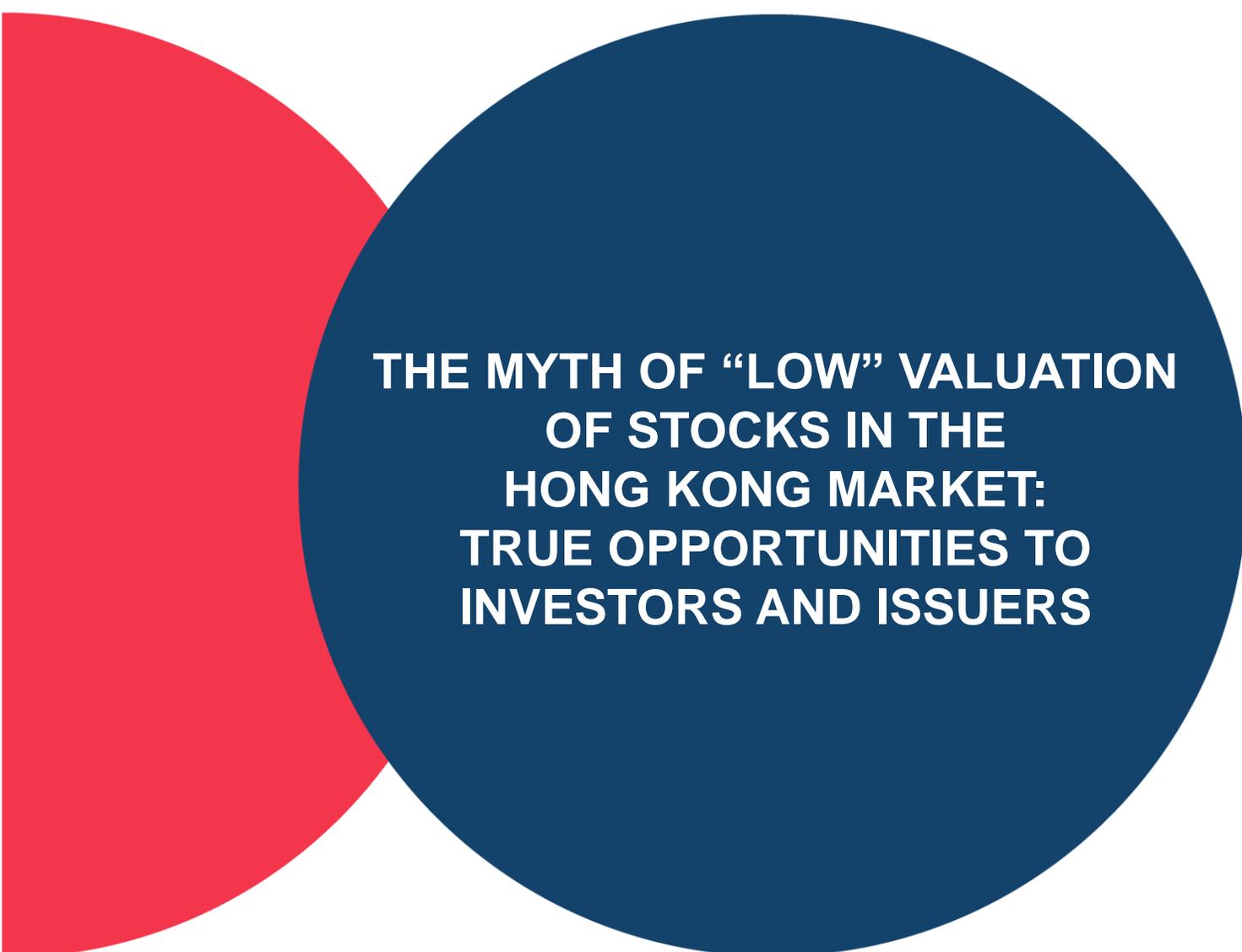


July 2016



**THE MYTH OF “LOW” VALUATION
OF STOCKS IN THE
HONG KONG MARKET:
TRUE OPPORTUNITIES TO
INVESTORS AND ISSUERS**

HKEX
香港交易所

Chief China Economist's Office

AGENDA

1

General Market Perceptions

2

Price Differentials in the Secondary Market

3

Price Differentials in the Primary Market

4

Sources of Difference

5

Opportunities Offered by the Hong Kong Market

6

Conclusion



DISCLAIMER

The information contained in this presentation is for general informational purposes only and does not constitute an offer, solicitation, invitation or recommendation to subscribe for or purchase any securities or other products or to provide any investment advice of any kind. This presentation is not directed at, and is not intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hong Kong Exchanges and Clearing Limited (“HKEX”) to any registration requirement within such jurisdiction or country.

This presentation contains forward-looking statements which are based on the current expectations, estimates, projections, beliefs and assumptions of HKEX about the businesses and the markets in which it and its subsidiaries operate or aspires to operate in. These forward-looking statements are not guarantees of future performance and are subject to market risk, uncertainties and factors beyond the control of HKEX. Therefore, actual outcomes and returns may differ materially from the assumptions made and the statements contained in this presentation. The implementation of these initiatives is subject to a number of external factors, including government policy, regulatory approval, the behaviour of market participants, competitive developments and, where relevant, the identification of and successful entry into agreements with potential business partners. As such, there is no guarantee that the initiatives described herein will be implemented, or that they will be implemented in the form and timeframe described herein.

Although the information contained in this presentation is obtained or compiled from sources believed to be reliable, HKEX does not guarantee the accuracy, validity, timeliness or completeness of the information or data for any particular purpose, and shall not accept any responsibility for, or be liable for, errors, omissions or other inaccuracies in the information or for the consequences thereof. The information set out in this presentation is provided on an “as is” and “as available” basis and may be amended or changed. It is not a substitute for professional advice which takes account of your specific circumstances and nothing in this document constitutes legal advice. HKEX shall not be responsible or liable for any loss or damage, directly or indirectly, arising from the use of or reliance upon any information provided in this presentation.

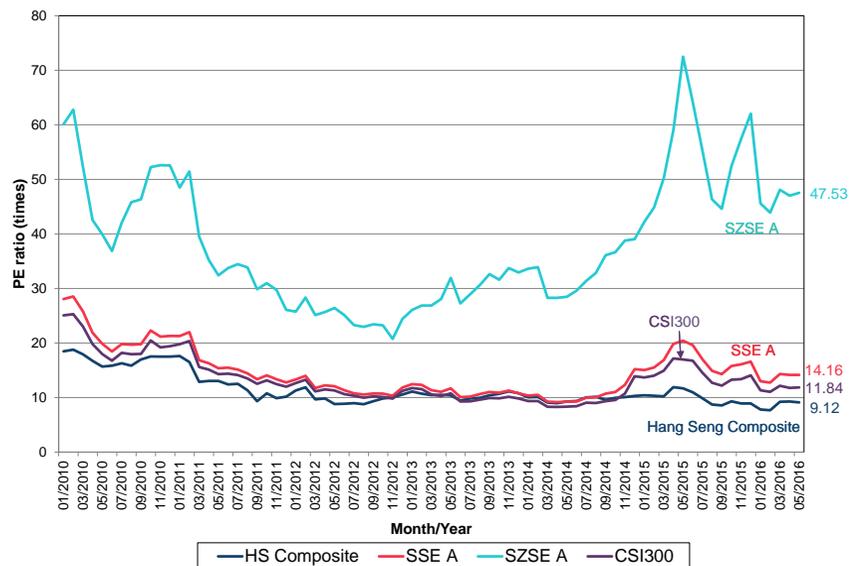


1. General Market Perceptions

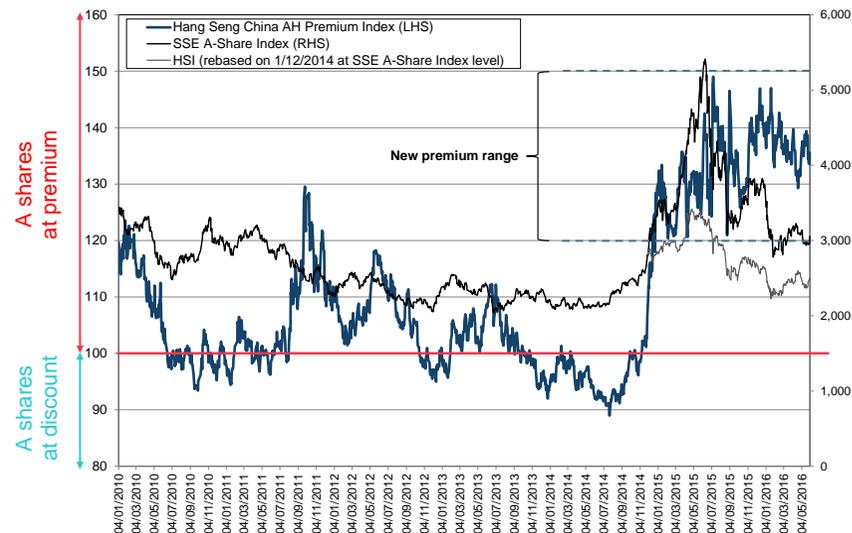
Valuation by market capitalisation (MC)-weighted PE ratio of market index

- Low PE ratio of Hang Seng Composite Index vs A-share indices
- A shares at a premium as measured by the Hang Seng China AH Premium Index
- **Superficially**, the Hong Kong market has lower valuation than the Mainland A-share market

Month-end PE ratios of HK and Mainland



Hang Seng China AH Premium Index

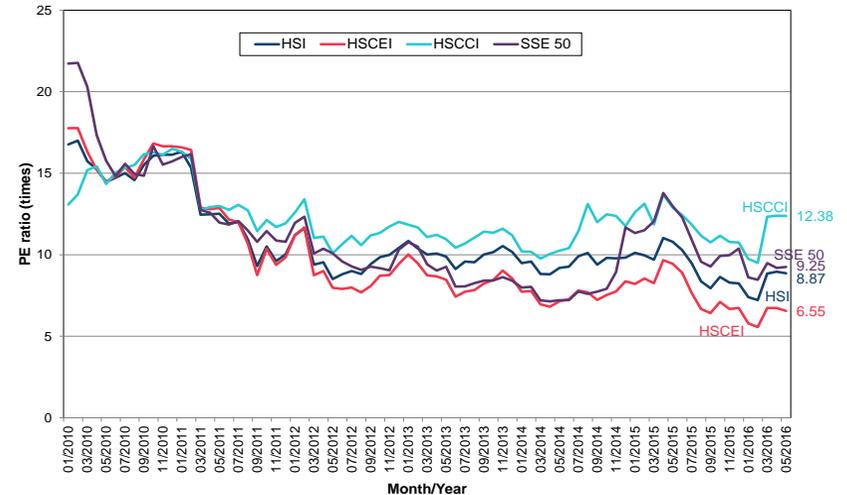


2. Price Differentials in the Secondary Market

Differentials across indices in a market

- Valuation of different Mainland stocks listed in HK also varies.
- On Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE), the more smaller-sized stocks are included in an index, the higher the PE ratio tends to be.

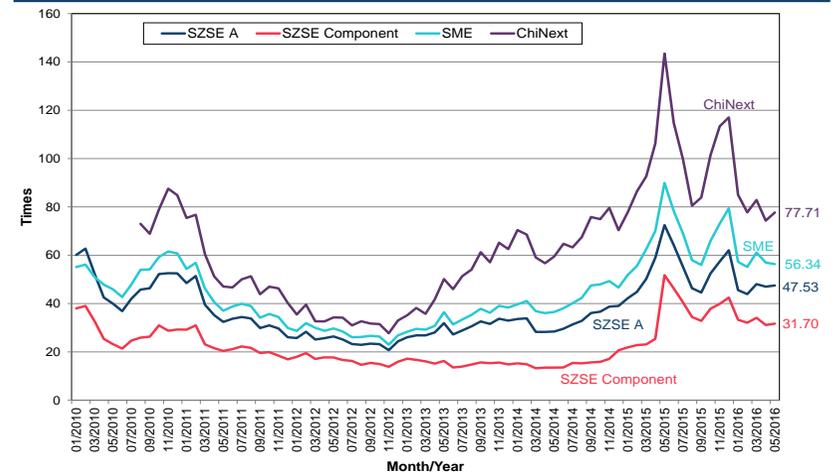
PE of key indices in HK vs Shanghai



PE of key indices on SSE



PE of key indices on SZSE

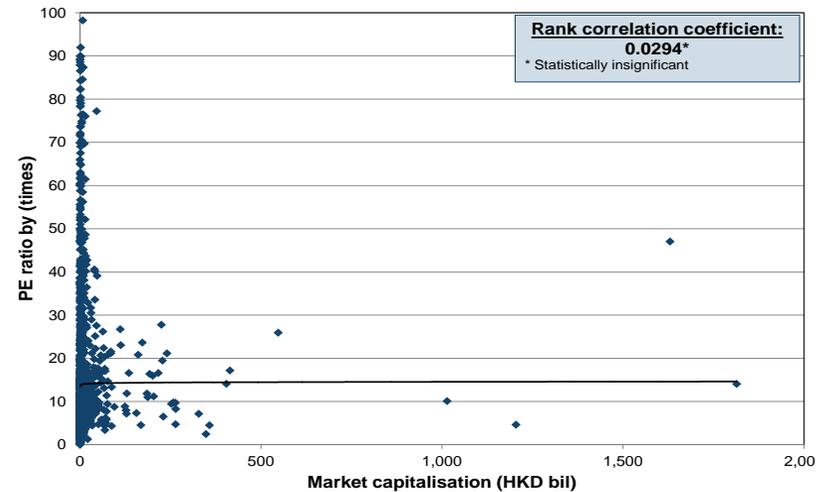


2. Price Differentials in the Secondary Market

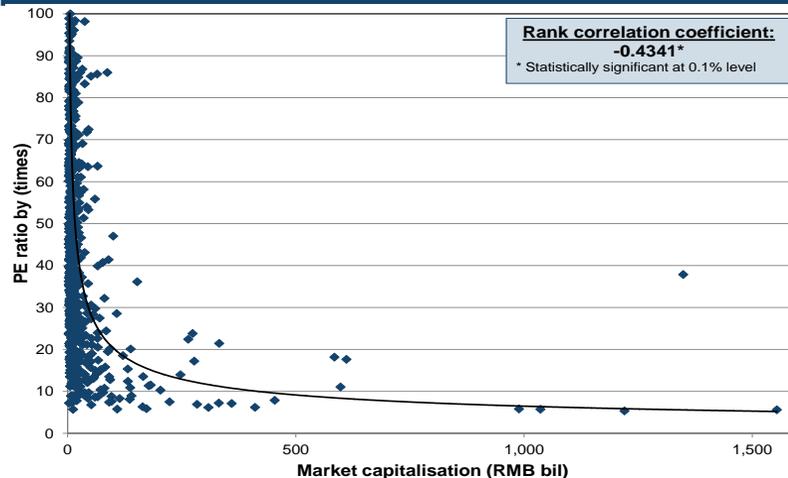
Differentials across company size

- On SSE and SZSE, the larger the company size (measured by MC), the lower the PE ratio tends to be.
- In the HK market, the PE is rather stock specific, irrespective of the company size.

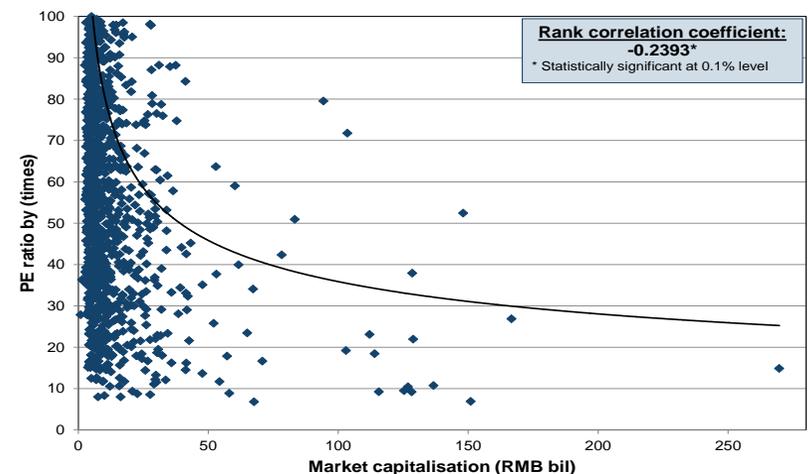
PE by MC on HKEX



PE by MC on SSE



PE by MC on SZSE



2. Price Differentials in the Secondary Market

Differentials across industrial sectors

- SSE stocks in the relatively mature industries of Financials and Utilities had similarly low (MC-weighted) PE as their HK counterparts.
- HK-listed H shares had higher (MC-weighted) PE than the HK blue chips in the Industrials and Energy sectors but lower (MC-weighted) PE in other sectors where both had constituent stocks for comparison.
- The SZSE market, consisting of mostly small growth companies, had the highest (MC-weighted) PE across almost all sectors.
- Industrial sector may not be a crucial factor in stocks' PE but stocks in certain sectors, by sector nature, may tend to have higher or lower PE than other sectors.

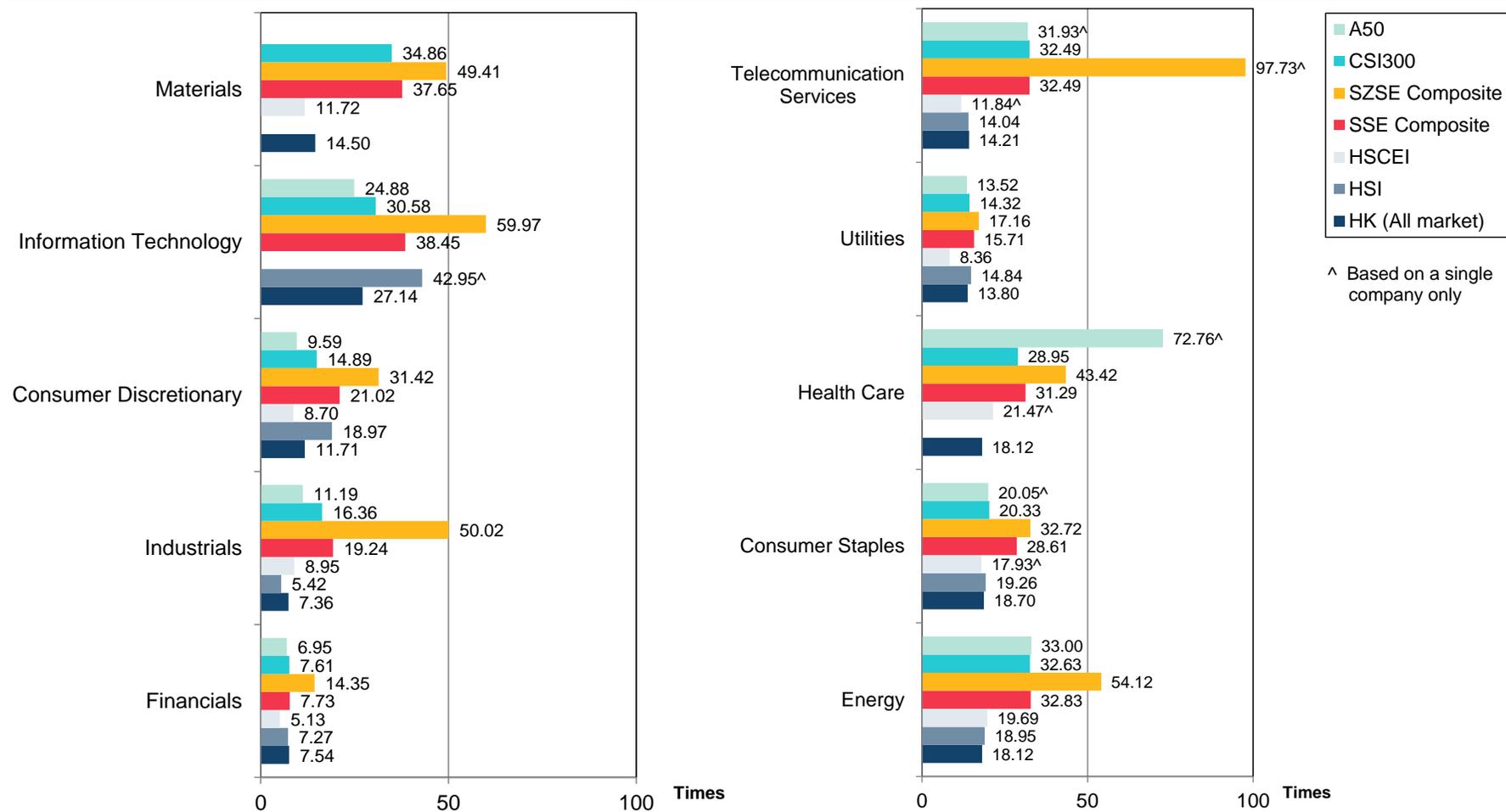
(See chart on next slide)



2. Price Differentials in the Secondary Market

Differentials across industrial sectors

MC-weighted PE by sector in Hong Kong and Mainland (31 May 2016)

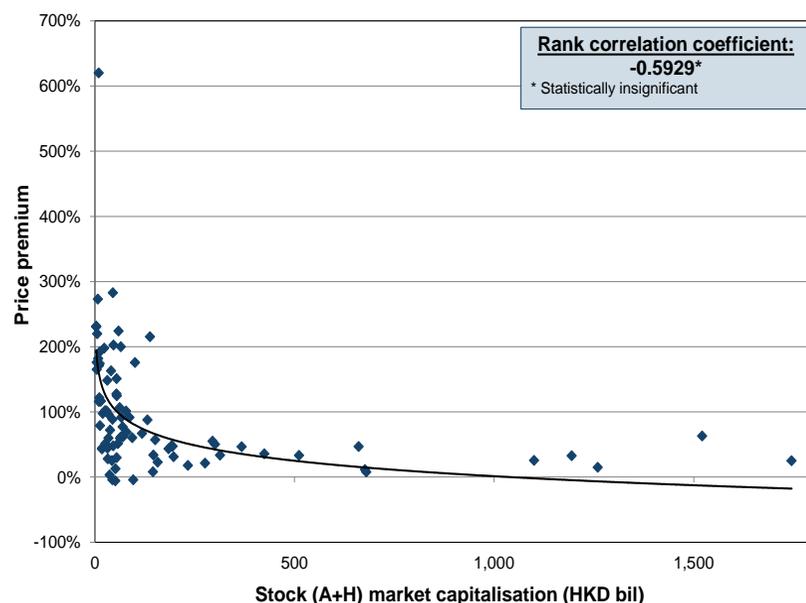


2. Price Differentials in the Secondary Market

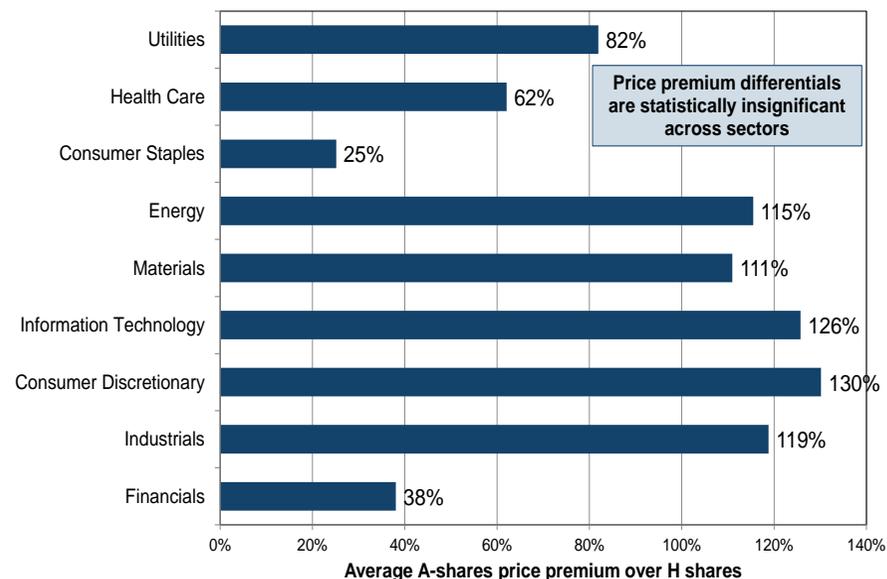
Differentials across A-H stocks

- The larger the company size, the smaller the A-H price premium irrespective of the industrial sector (believed to owe to the negative relationship between stock valuation and MC for stocks listed in the Mainland).

A-H price premium vs MC (31 May 2016)



A-H price premium across sector (31 May 2016)

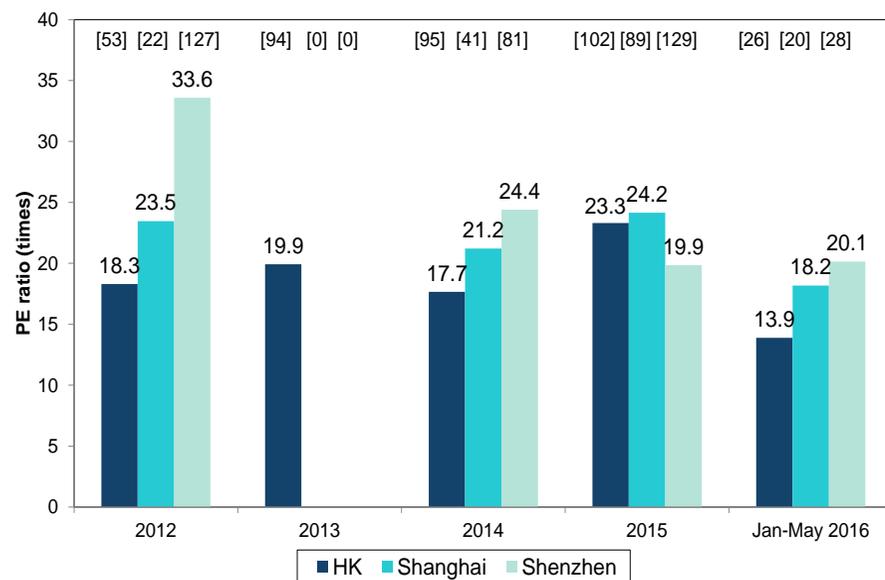


3. Price Differentials in the Primary Market

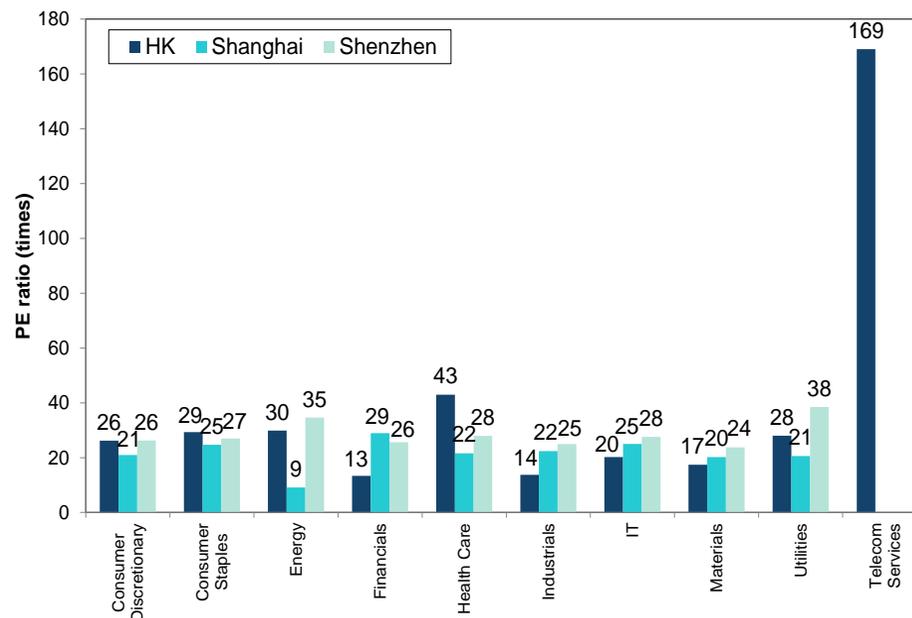
- During the period of 2012 to May 2016, IPOs in Hong Kong had higher valuation than IPOs in Shanghai in a number of sectors (and higher valuation than IPOs in Shenzhen for some of these sectors) — Consumer Discretionary, Consumer Staples, Energy, Health care and Utilities.

MC-weighted PE of IPOs in HK vs Mainland (2012 – May 2016)

By year



By industrial sector



[] No. of IPOs

Note: Excluding cases with negative or null PE value.



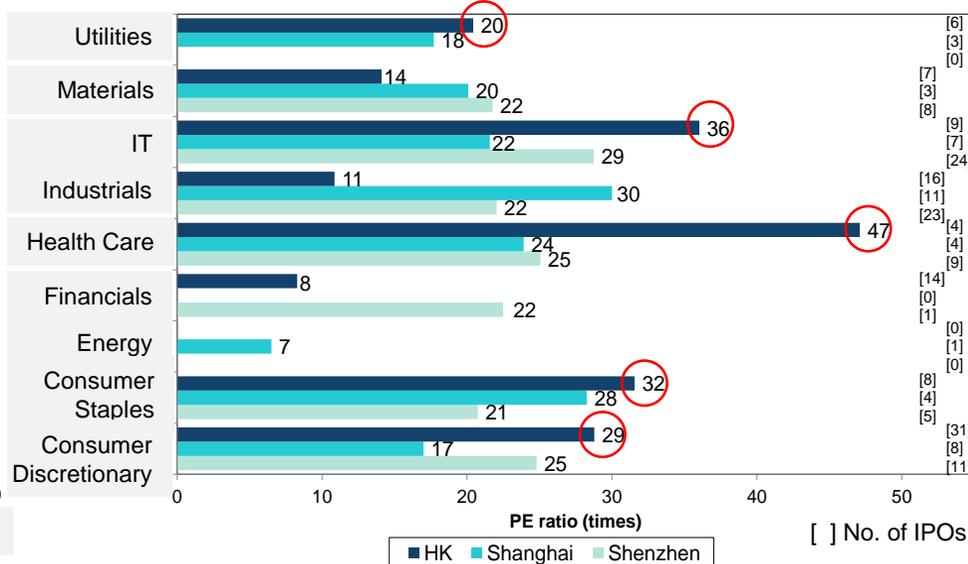
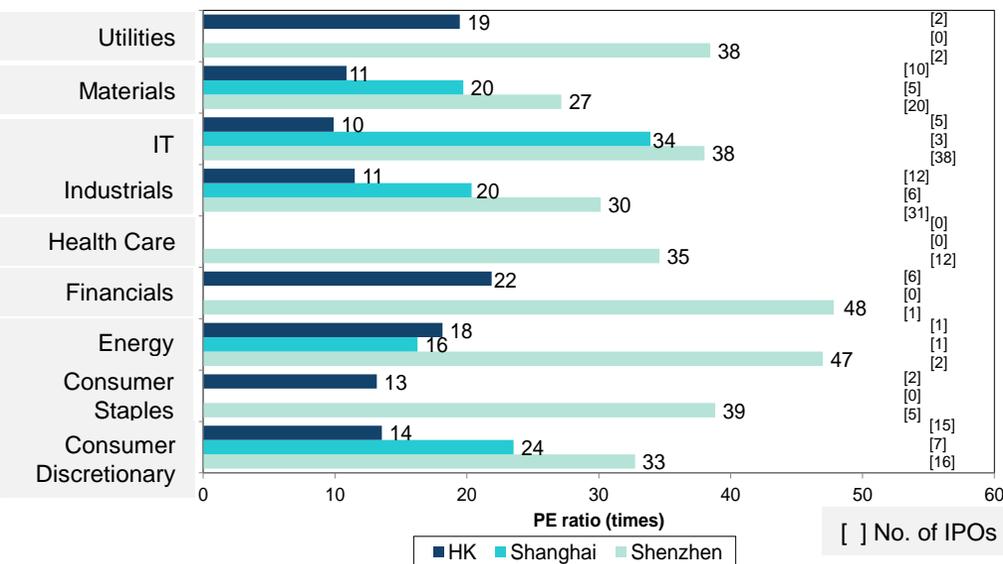
3. Price Differentials in the Primary Market

- IPO in Hong Kong had higher valuation than those in the Mainland for multiple sectors in each year after 2013.

MC-weighted PE of IPOs in HK vs Mainland by sector

2012

2014



○ MC-weighted PE of IPOs in HK higher than in Mainland

Note: IPOs in the Mainland market was suspended in 2013.
Excluding cases with negative or null PE ratios.

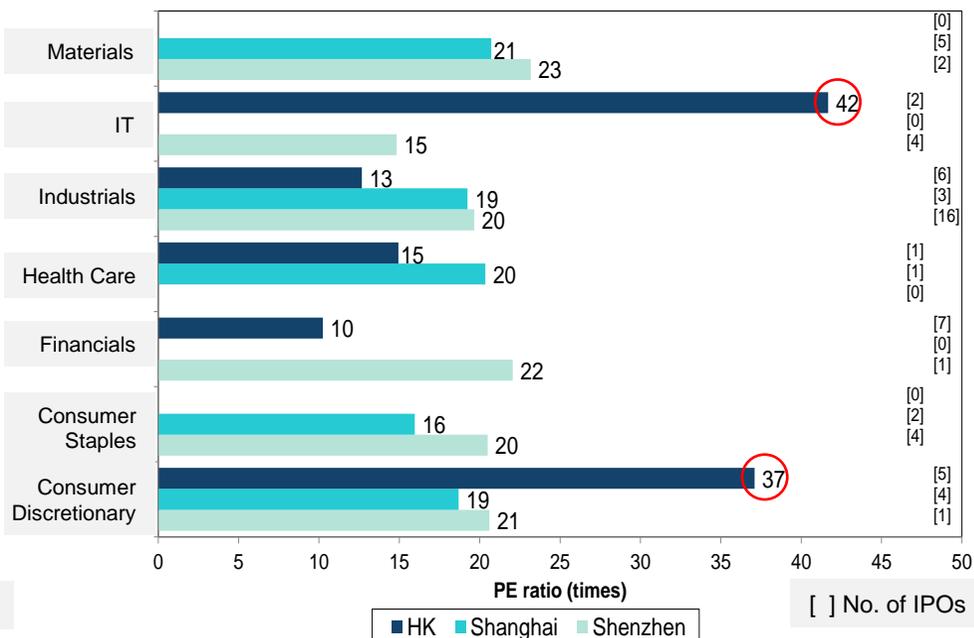
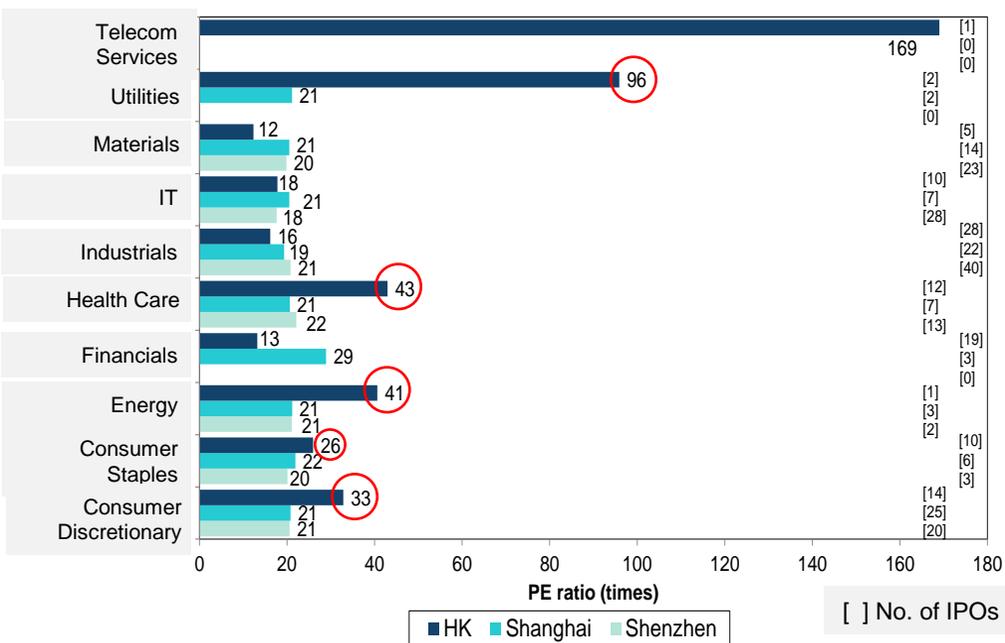


3. Price Differentials in the Primary Market

MC-weighted PE of IPOs in HK vs Mainland by sector

2015

Jan – May 2016



○ MC-weighted PE of IPOs in HK higher than in Mainland

Note: Excluding cases with negative or null PE ratios.

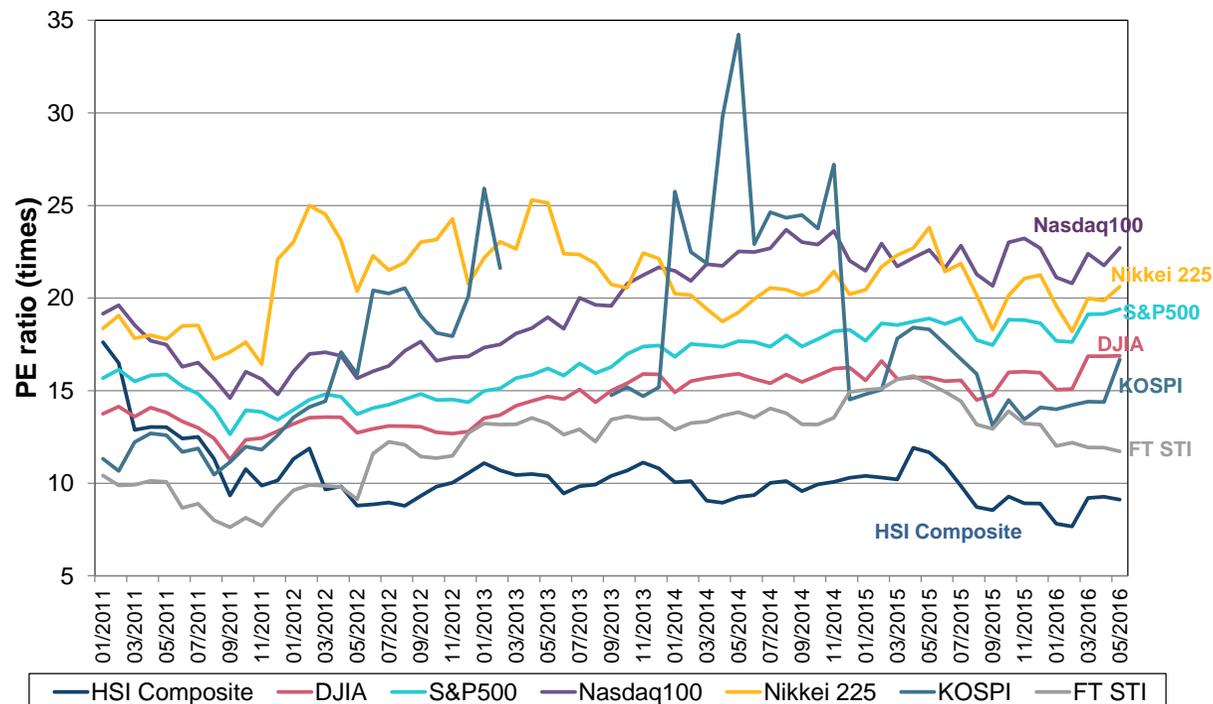


4. Sources of Difference

Market norms of PE ratio

- Each stock market in the world¹, irrespective of the degree of openness, tends to maintain its “normal” level of PE ratio during a period of time — the **market norm**.
- **Possible underlying factors:** industry composition, listed companies’ stage of development, investor base or structure, investor maturity and their investment behavior.

Month-end PE ratios of selected world key indices (Jan 2011 – May 2016)



¹ The Korean market is a special case where the PE ratio fluctuated a lot.

Data source: Wind for HSI Composite, Bloomberg for other indices (data is not available for KOSPI during Mar-Aug 2013).

4. Sources of Difference

Industry composition of listed companies

- Markets with more weighting by MC in new economy industries (e.g. technology and health care) would tend to have a higher MC-weighted average PE level.
- Markets with more weighting in the financial industry would tend to have a lower PE level.

HK vs US market

	MC weighting			PE
	Financials	IT	Health care	
All HK stock*	43%	10%	2%	9.12
DJIA^	20%	14%	12%	15.61
S&P500^	17%	17%	14%	19.18
Nasdaq 100^	0.1%	52%	14%	23.50

HK vs Mainland market**

	MC weighting			PE
	Financials	IT	Health care	
HSCEI	81%	—	1%	5.78
FTSE A50	61%	2%	1%	9.06
HSI	48%	13%	—	9.68
CSI300	42%	5%	4%	11.83
SSE	37%	4%	4%	13.47
SZSE	10%	22%	10%	35.94

* As at 31 May 2016; source: HKEX analysis based on data from Bloomberg

^ As at end-2015; source: "The Nasdaq-100, Trading Innovation in Large-Cap Growth", Feb 2016

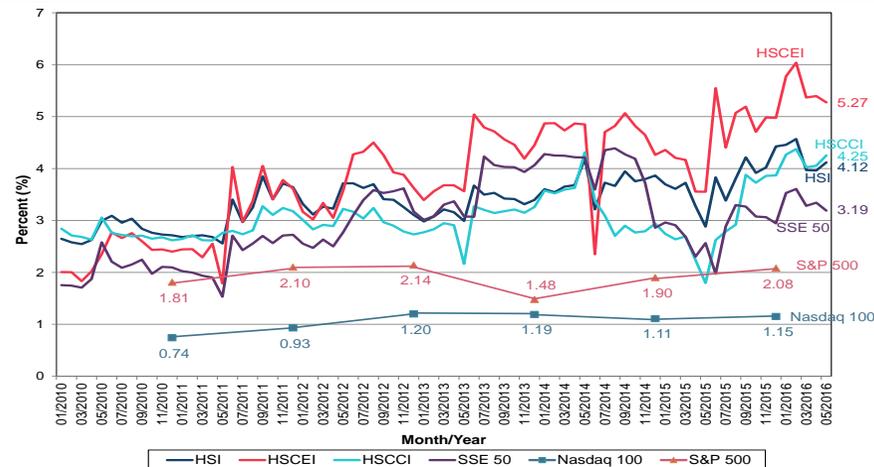
** As at 31 May 2016; source: HKEX analysis based on data from Bloomberg

4. Sources of Difference

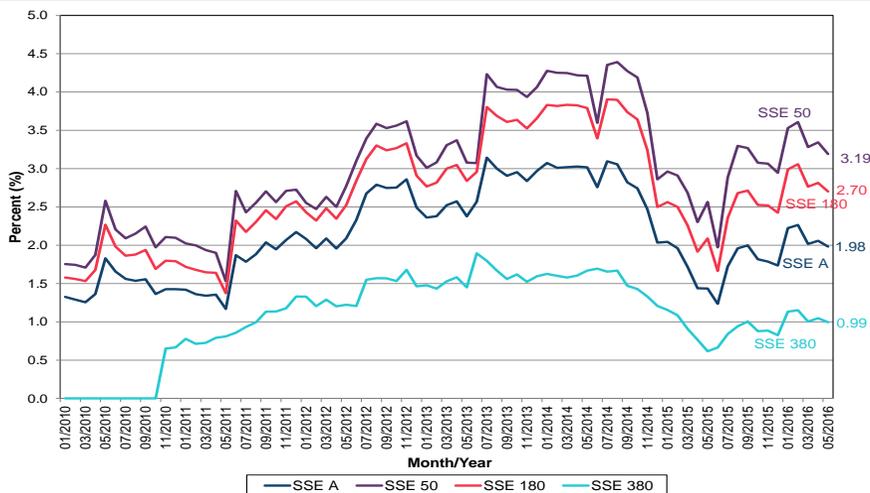
Dividend yield as part of stock valuation

- Indices having higher PE ratio tend to have a lower dividend yield and vice versa, probably due to the nature of the constituents (growth stocks vs mature stocks).
- Stocks/markets with low PE may be compensated by high dividend yields in total return.

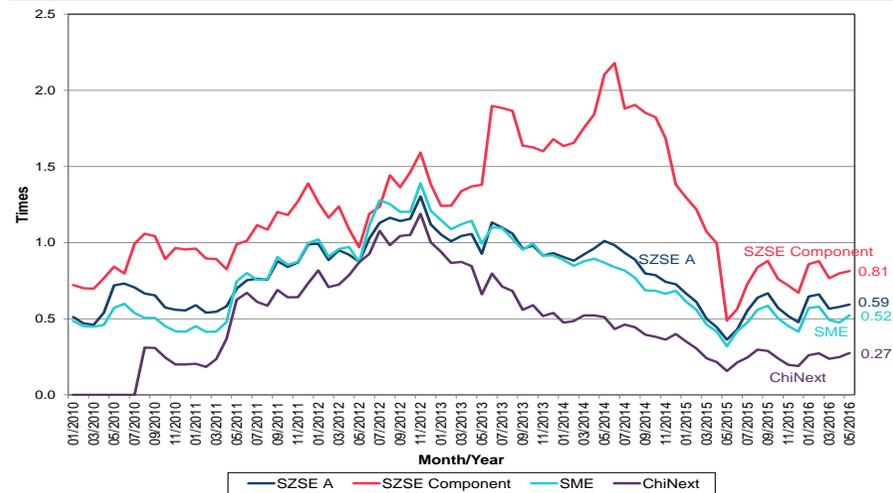
Dividend yield in HK, Shanghai and US



Dividend yield of key indices in Shanghai

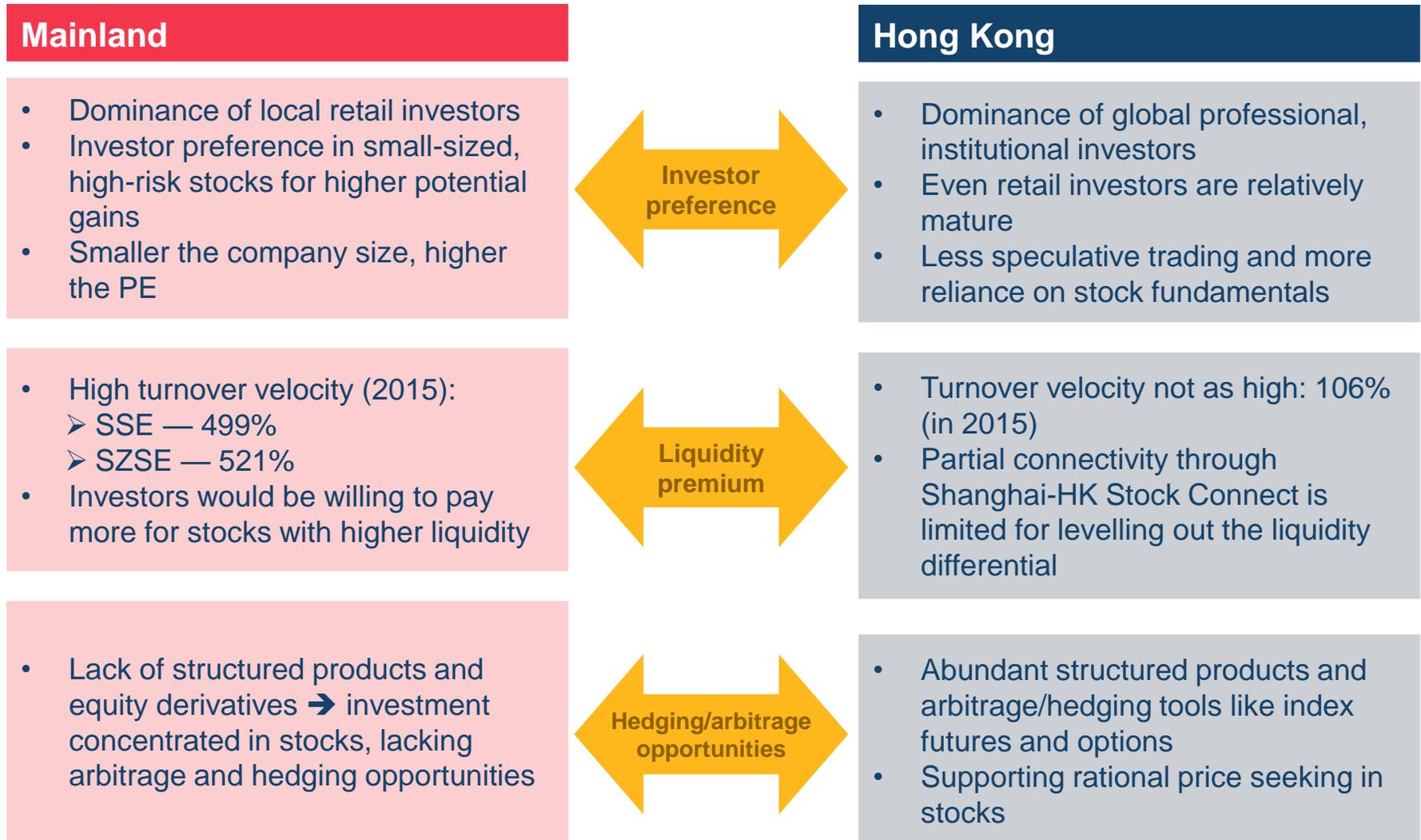


Dividend yield of key indices in Shenzhen



4. Sources of Difference

Mainland's specific factors



5. Opportunities Offered by the Hong Kong Market

Lower-priced H shares of AH stocks

Benefit from higher dividend yield than holding corresponding A shares on the same stock fundamentals

Comprehensive range of investment tools

Enhanced capability to cope with risky market conditions and exposed to more profit opportunities than in the Mainland

Higher IPO pricing in certain industries

E.g. consumer goods, energy and health care

Market appetite for new economy stocks

Plenty of room for more stocks in new economy industries like IT and health care

More flexible IPO and post-listing fund raising regime

Enabling timely commercial decision of IPO and post-listing fund raising activities

International listing platform

A platform with international investment practice and regulatory standards and professional investor base to offer issuers opportunities in international branding and global business expansion

6. Conclusion

Myth

“Low” valuation of stocks listed in Hong Kong vis-à-vis Mainland China

Facts

- Mainland market has positive valuation differentials at the macro level
- Hong Kong market has positive valuation differentials at the micro level of individual stocks and industries

Sources of price differentials

- Difference in market characteristics — each market has its “market norm” of PE level
- Industry composition varies
- Dividend yield as part of stock valuation
- Mainland investors’ preference for small-sized high-risk stocks
- Liquidity premium in the Mainland
- Lack of investment opportunities and instruments for hedging/arbitrage

Opportunities offered by HK

- Lower-priced higher yield H shares of A-H stocks
- Profit opportunities and risk management offered by hedging/arbitrage tools
- Higher pricing in certain industry sectors
- Market appetite for stocks in new economy industries
- Flexible IPO and fund raising regime
- International listing platform